NH HICKS

Legal and Pension Consultants

QUALIFIED PLANS IN TODAY'S ENVIRONMENT

Fiduciary & Legal Review

2020

NH HICKS

Legal and Pension Consultants
www.nhhicks.com

Who we are:

NH HICKS is a multi-generational company with one goal: To provide the best service, value and price in the retirement plan industry.

Each client is assigned an administrator and a consultant. Our administrators have over 250 years of combined experience. This provides administrative support by which we can ensure that all plan administration is performed in a timely manner, with a high degree of expertise. Our consultants assure a presence for one-on-one meetings to design and explain a plan that best fits a company's business and its retirement goals.

What we do:

NH HICKS specializes in quality pension plan administration with local service at a reasonable cost. We are a fee only third party pension administration and consulting firm that does not handle any investments or insurance. We offer flexibility through individually designed retirement plans and self-directed retirement accounts. Self-directed gives clients freedom to choose their own investments.

We currently administer over 1000 qualified retirement plans primarily throughout California, Oregon, Washington, Colorado, Utah and Idaho. Our goal is to provide excellent service to all clients by working closely with their tax and financial advisors.

Given the continuous stream of regulations, our firm and legal department are unsurpassed in experience and constantly updating and adapting to today's regulatory environment. Our annual plan review keeps our clients up-to-date with the best possible plan options along with keeping your plan in compliance with the latest IRS and DOL regulations.

www.nhhicks.com:

Our website is being updated daily with the newest regulations, common trends and articles from leaders in the financial industry. We have adapted to new technology, gone paperless, expanded our website and brought value through actively participating in numerous social media forums. You will also be able to find our complete staff biographies, email addresses, fees, forms, FAQ's and other vital information.

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PLAN DESIGN HIGHLIGHTS

FIDUCIARY & LEGAL ISSUES

- Litigation Updates – Tibble and Anthem
- Significance of Fiduciary Status
- 3(16) vs. 3(21) vs. 3(38) Fiduciary
- The SECURE Act
- New Plan Set Up Deadline
- Changes Due to Covid-19
- ERISA Fee Disclosure
- Investing in Real Estate
- Determination of Controlled Group
- Red Flag Issues
- Compliance Assistance
- Missing Participants

SUMMER IS A GREAT TIME FOR A PLAN CHECK-UP

As the summer months approach and things slow down, now is a perfect time to be proactive and review your retirement plan and all its components. This month we provide areas of review and resources to help you and your clients accomplish this important task.

PLAN DOCUMENT: Every plan sponsor and fiduciary needs to make sure the plan is running properly. The document is the first line of defense. It should be reviewed to make sure it's been restated and the administration is being run according to the plan provisions. The IRS has created a checklist to help identify issues regarding documents. It can be viewed here.

Is the plan accomplishing the goals of the employer in providing benefits and tax breaks to those who need it the most? In the event of a plan audit, here is a link to our website and the sample IRS and DOL letters requesting information. Notice the extensive requests for documents and amendments.

ANNUAL ADMIINSTRATION: This is highly technical work and mistakes can be made in the administration process. Eligibility, vesting, accounting, loans and payments to and from the trust should be reviewed by an independent third party at least periodically. We all make mistakes, and if one is caught before an audit, there are various IRS and DOL programs in place that allow for self-correction.

The IRS has a plan checklist that outlines the requirements and issues to look for regarding the operation of these plans. This is helpful in that it gives insight into what the IRS is targeting should your plan be audited. To review, click here.

THE FIDUCIARY PROCESS: This is the "Hot Topic" of this year. There are new regulations and court cases regarding breaches of fiduciary duties and failure to exercise their duties. A thorough review of the decision making process is paramount to protecting everybody who works with these plans.

As an investment advisor, your job is to help in the drafting of the investment policy statement (IPS). This is the basis for the selection of investments. It needs to be written and should spell out the process by which funds are chosen. As a plan grows, it should be able to get cheaper funds because of the amount of assets. You cannot "set it and forget it" as the case of Tibble.

FEES: The 408(b)(2) regulations require that trustees understand the fees they and their participants are paying. Are they reasonable? Are they getting the proper value and service for what they are paying? Is anybody receiving "kickbacks" or other hidden fees, and are they being offset against administration costs? All of this is important because, in most 401(k) plans, the participant's accounts are being charged something. This annual review requires 3 things: REVIEW, BENCHMARK and DOCUMENTATION. For additional information, click here.

Are the participants getting the proper disclosures, statements and education they need? Ultimately, as a fiduciary, the plan sponsor's job is to put their participants first. They should review the information and educational materials provided to them. Annual meetings, website access to information, and other materials are important to fulfilling these duties. As a financial planner, it is your job to provide these services. The participants and fiduciaries depend on you. Don't forget to document the meeting and decision making process.

IN CONCLUSION: We have only scratched the surface of the various issues. The rules are being clarified through new regulations and court cases. We are providing a series of webinars next month where all of these issues are discussed further. For the invitation for these free webinars, click here.

As always, we are always available for questions, comment or proposals. Summer is here, now is the time!!

3(16) vs. 3(21) vs. 3(38) Fiduciary
What's the Difference?

"A retirement plan adviser can serve in with a 3(16), 3(21) or 3(38) fiduciary capacity, and in some cases, both capacities. The needs and desires of the plan sponsor typically dictate the specific arrangement, which is predicated upon the subject of risk mitigation versus risk avoidance."

3(16)
Named & acts as Plan Administrator
Oversees Management & Administration
Selection, evaluation & monitoring all providers
Evaluation of all plan fees
Delegate administration responsibilities
Oversee operation of Plan
Provide reporting & disclosure materials

3(21)
States in writing co-fiduciary status
Assists in drafting IPS
Helps design initial fund menu
Provides monitoring
Recommends changes
Recommends mapping strategies
Provides Documentation

3(38)
States in writing co-fiduciary status
Drafts IPS
Builds initial fun menu
Monitors menu
Makes changes
Determines mapping strategies
Provides Documentation

3(21) vs. 3(38) Fiduciary; What's the Difference? Gratke Wealth. David Gratke. 11-1-2011.
http://davidgratke.com/401k/321-vs-338-fiduciary-whats-the-difference/

HICKS LEGAL
Fiduciary and Compliance Review Services

Why are Retirement Plan Fiduciaries turning to Independent Fiduciary Advisors?

ERISA imposes high standards upon fiduciaries. The courts refer to those duties as “the highest known to law”. Retirement Plan fiduciaries may be personally liable if they know, or should have known, of a breach by another fiduciary. Pleading ignorance or inexperience will not be an adequate legal defense. Complying with the broadly expanded 408(b)(2) Regulations is a daunting task. ERISA encourages plan sponsors to hire “Prudent Experts”.

To comply with the new 408(b)(2) regulation, a responsible plan fiduciary will develop procedures that will demonstrate that its arrangements with third-party service providers are reasonable. Documenting the process by which the required information is solicited, reviewed, and evaluated is the most effective means to achieve compliance. We provide individual consultation with a California Attorney to protect fiduciaries from this liability. We will meet with you to:

1. Identify an individual or committee that will be responsible for identifying covered service providers and soliciting and evaluating the required disclosures. The disclosures must be received “reasonably in advance” of the date the service provider contract or arrangement is entered into, extended, or renewed.

2. Implement a written policy or procedure to identify the duties of the responsible individual or committee, the required elements of disclosure (which differ depending on the type of covered service provider), and the process to be followed if the required disclosures are not provided, in whole or in part.

3. Document the responsible individual’s or committee’s review of the information disclosed and the report of its findings to the fiduciary with ultimate responsibility for entering into the service provider contract or arrangement. Document the process by which such fiduciary decision-making is made.

4. Provide “benchmarking” services to allow the responsible plan fiduciary to evaluate and compare the service provider’s aggregate compensation with other comparable service providers and industry standards, and to otherwise assist in supporting the process by which the fiduciary determines and documents that a service provider’s compensation is reasonable.

Procedural due diligence is especially important in evaluating the performance of investment options offered under a 401(k) or 403(b) plan where participants can direct the investment of their own accounts. Direct and indirect fees and other charges affect the value of participants’ accounts, and the documentation of procedural diligence can provide an effective defense in the event of litigation claiming that the plan fiduciary has violated its duty to monitor fees and expenses.

The SECURE Act

As part of a larger government spending package, which was signed into law on December 20, 2019, Congress included provisions from the Setting Every Community Up for Retirement Enhancement (SECURE) Act. The act reflects policy changes to defined contribution plans, defined benefit pension plans, individual retirement accounts (IRAs), and 529 college savings accounts. Most provisions in the law go into effect on January 1, 2020.

Here is a summary of some key provisions of the SECURE Act:

Required minimum distributions (RMDs) now begin at age 72
Americans are working longer and will no longer be required to withdraw assets from retirement plans and IRAs at age 70½. RMDs now begin at age 72 for individuals who turn 70½ in the calendar year 2020 and later.

IRA contributions beyond age 70½
As Americans live longer, an increasing number are continuing to work past their traditional retirement age. Under the SECURE Act, employees can continue to contribute to their traditional IRAs past age 70½ if they are still working. That means the rules for traditional IRAs will align more closely with retirement plans.

Long-term, part-time workers will be able to join the company 401(k) plan
Up until now, if an employee worked less than 1,000 hours per year, the employee was generally ineligible to participate in the company's 401(k) plan. Except in the case of collectively bargained plans, the law now requires employers maintaining a 401(k) plan to offer a plan to any employee who worked more than 1,000 hours in one year, or 500 hours over 3 consecutive years. Employer contributions are not required for these employees even if the plan is top-heavy. Although employers need to start tracking these part-time employees, the earliest entry date of these employees will be January 1, 2023.

Increased tax credit for starting a retirement plan, up to $5,000
The new law provides an increased start-up retirement plan credit for smaller employers of $250 per non-highly compensated employees eligible to participate in a plan at work (minimum credit of $500 and maximum credit of $5,000). This credit would apply to small employers with up to 100 employees over a 3-year period beginning after December 31, 2019 and applies to SEP, SIMPLE, defined contribution plans, and defined benefit plans.

$5,000 withdrawal per parent penalty-free upon the birth/adoption of a child
The new law permits an individual to take a "qualified birth or adoption distribution" of up to $5,000 from an applicable defined contribution plan, such as a 401(k) or an IRA. The 10% early withdrawal penalty will not apply to these withdrawals, and you can repay them as a rollover contribution to an applicable eligible defined contribution plan or IRA.

This is a summary of some of the key provisions that affect retirement plans. If you need more information, please contact us at NH Hicks.

New Plan Set Up Deadlines

The **Setting Every Community Up for Retirement Enhancement (SECURE) Act** was passed in December 2019 and made policy changes that will impact the adoption of new defined contribution plans and defined benefit plans. Here are the new plan deadlines for 2020 and beyond.

Start-Up Safe Harbor Plan: October 1st

This deadline has not changed. If an employer does not currently sponsor a retirement plan and is interested in starting a safe harbor 401(k) plan, the deadline is 90 days before year end. That means October 1, 2020 to install a new safe harbor plan for this year.

Adding Safe Harbor Provisions for 2020: Dates vary

If the client already sponsors a 401(k) plan and is looking to add a safe harbor provision, there are now different deadlines depending on the safe harbor provisions.

- <u>Safe Harbor Match</u>: The deadline to add a safe harbor match remains unchanged at 30 days before the start of the plan year. An employer has until December 1, 2020 to add a safe harbor match for 2021.

- <u>3% Non-Elective Safe Harbor</u>: A plan sponsor has until 30 days before the end of the plan year to add a 3% non-elective safe harbor provision. That is December 1, 2020 for calendar year plans.

- <u>4% Non-Elective Safe Harbor</u>: If the plan sponsor misses the 3% safe harbor deadline above, there is a new option available. They can now add a safe harbor non-elective provision up to the last day of the following plan year if the plan sponsor is willing to contribute 4% of pay instead of the 3%. So, they have until December 31, 2021 to add a 4% non-elective safe harbor provision to their plan for 2020.

Profit Sharing or Defined Benefit Plans:
Due date of business tax return plus extensions

An employer can now set up a plan, and make deductible contributions, until the due date of the employer's 2020 tax return plus extensions. It is important to note that this only applies to employer contributions, as it is not possible to make 401(k) deferrals retroactively to the previous year. This extra time provides a great opportunity for companies to achieve some additional tax savings right at the time they realize it the most …. as they are looking at a large tax payment due to the IRS.

We think the SECURE Act offers qualified plan opportunities and a little reprieve from the effects of potential procrastination. NH Hicks is always here to help our advisors and clients.

Key Defined Contribution Takeaways from the CARES Act

The coronavirus (COVID-19) emergency has placed the United States in a challenging and unique position that many of us have never experienced before. Many employers are facing closures of offices and businesses resulting in layoffs or furloughs, or work from home situations. In response, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) was signed into law on March 27, 2020. Below is a description of the key CARES Act provisions:

Coronavirus-Related Distributions

Plans may permit in-service coronavirus-related distributions from a participant's vested account balance without regard to the normal withdrawal restrictions. This relief is offered through December 31, 2020.

These distributions are subject to the following requirements:

- Limited to $100,000 per tax year, aggregated across all plans of the employer or controlled group.
- Not subject to 20% mandatory tax withholding upon distribution.
- Exempt from 10% early withdrawal penalty even participants who are 59-1/2 or younger.
- Eligible to be indirectly rolled into an IRA or employer plan within 3 years from the date the distribution is taken.
- Amounts not indirectly rolled into an IRA or employer plan are included in gross taxable income, pro rata, over 3 tax years, unless the participant elects to include all amounts in a single tax year.

Coronavirus-related distributions are available to "eligible" participants who:

- Are diagnosed with a coronavirus (COVID-19 or SARS-CoV-2) illness.
- Have a spouse or dependent diagnosed with a coronavirus illness.
- Experience "adverse financial consequences" as a result of a quarantine, furlough, lay-off, reduction in work hours, business closure, the lack of childcare, or other factors determined by the IRS due to the coronavirus emergency.

A plan administrator may rely on a participant's certification of the above.

Coronavirus-Related Loan Relief

Two types of loan relief were also provided:

1. Plans may allow eligible participants, as defined above, to take loans up to the lesser of $100,000 or 100% of the participant's vested account balance for the specified period.
2. Upon the request of an eligible participant, plan sponsors must suspend loan repayments due on outstanding loans that are in good order for a period of up to 12 months. This relief expires on December 31, 2020. The suspension period is to be added to the original loan term when repayments, including accrued interest, resume, regardless of the length of the loan's original term.

The calculation method of the maximum loan available remains the same including the offset of prior loans within the last year.

Waiver of 2020 Required Minimum Distributions (RMDs)

A Distribution from an "Eligible Retirement Plan," (an IRA, 401(a) plan (including 401(k), 403(b), and governmental 457(b)) will not be required to make any RMD payments for 2020. Specifically:

- Participants who turned age 70½ prior to 2019 will not be required to receive an ongoing RMD for 2020.
- Participants who turned age 70½ in 2019 and who did not receive their first RMD for 2019 on or before January 1, 2020 will not have to receive their first (2019) RMD or their 2020 RMD.
- Beneficiaries receiving life expectancy payments will not be required to receive their 2020 beneficiary RMD.
- Beneficiaries who have an account balance in the plan subject to the five-year distribution rule may extend their required distribution by one year (full distribution of the account must be made by the 6th anniversary of the participant's death).

If a 2020 RMD is provided to any of the above, it may be rolled over to an IRA or employer plan. A participant's RMD or beneficiary's life expectancy RMD for 2021 will need to be paid.

Timing of Plan Amendments

The CARES Act includes a remedial amendment period giving plan sponsors additional time to amend their plans for this relief. Sponsors have until the last day of the plan year beginning in 2022 to amend their plans, i.e., December 31, 2022 for a calendar year plan.

Key Defined Benefit Takeaways from the CARES Act

The coronavirus (COVID-19) emergency has placed the United States in a challenging and unique position that many of us have never experienced before. Many employers are facing closures of offices and businesses resulting in layoffs or furloughs, or work from home situations. In response, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) was signed into law on March 27, 2020.

Below is a description of the key CARES Act provisions as they pertain to defined benefit (DB) plans:

Coronavirus-Related Loan Relief
Two types of loan relief were also provided:

1. Plans may allow eligible participants, as defined above, to take loans up to the lesser of $100,000 or 100% of the participant's vested account balance for the specified period.
2. Upon the request of an eligible participant, plan sponsors must suspend loan repayments due on outstanding loans that are in good order for a period of up to 12 months. This relief expires on December 31, 2020. The suspension period is to be added to the original loan term when repayments, including accrued interest, resume, regardless of the length of the loan's original term.

The calculation method of the maximum loan available remains the same including the offset of prior loans within the last year.

Coronavirus-related distributions are available to "eligible" participants who:

- Are diagnosed with a coronavirus (COVID-19 or SARS-CoV-2) illness.
- Have a spouse or dependent diagnosed with a coronavirus illness.
- Experience "adverse financial consequences" as a result of a quarantine, furlough, lay-off, reduction in work hours, business closure, the lack of childcare, or other factors determined by the IRS due to the coronavirus emergency.

A plan administrator may rely on a participant's certification of the above.

Waiver of 2020 Required Minimum Distributions (RMDs)
There is no waiver for required minimum distributions from defined benefit plans.

Delay in 2020 Funding Obligations
All single-employer funding obligations due during 2020 are not required to be made until January 1, 2021, with interest for payments made after September 15, 2020. The minimum funding requirement must be made by this deadline, or a 10% excise tax is due, and the funding deficiency is then added to the following year's funding requirement plus interest.

Timing of Plan Amendments
Plan sponsors have been provided additional time to amend their plans for this relief. Plan sponsors have until the last day of the plan year beginning in 2022 to amend their plans, i.e., December 31, 2022 for a calendar year plan.

Freeze Defined Benefit Plan due to COVID-19
Freezing a DB plan is one way to minimize funding requirements during times of economic turmoil. Plans can be frozen by amendment before the accrual period, typically when a participant works 1000 hours during the plan year. Freezing the plan before the accrual date stops participants from getting additional benefits until the plan is unfrozen and reduces the contribution. However, depending on the plan's funding status, a contribution may still be required. Here are some topics to consider in deciding whether to freeze the plan:

- Market Correction – If market corrects itself, freezing may not be helpful.
- Government Relief – More legislation could provide funding relief.
- Freezing Affects Future Contributions – Freezing a new DB plan can reduce the maximum funding for two plan years following the unfreeze.

We will provide further updates as they become available.

ERISA Fee Disclosures

408(b)(2) and 404(a)(5) are new ERISA regulations that require actions by the sponsors of all retirement plans with participant directed accounts. Each ruling has separate and distinct requirements. The purpose of these regulations is to ensure that plan fiduciaries (and plan participants who direct the investment of their individual accounts) have the information they need to make informed investment decisions.

Although much of the disclosure required by the new regulations is provided by investment companies or other service providers, plan fiduciaries will still need to educate plan participants about the fee disclosure and be prepared for questions from participants who will now see how much they are actually paying for certain services.

Here is a brief summary of these regulations:

- **408(b)(2) Disclosure to Plan Sponsors** – This regulation required "service providers" to provide plan fiduciaries with the following information in writing **by July 1, 2012:**

    1. A description of the services to be provided to the plan and/or plan participants (the services include those of registered investment advisors, brokerage firms, actuaries, accountants, and third party administrators);
    2. The fees and compensation deducted from participants accounts for those services.

    Once the plan sponsor has the disclosure, the next steps are to review it to determine whether the fees and services are reasonable and then document their findings.

    Failure to comply with these 408(b)(2) disclosure regulations constitutes a prohibited transaction subject to a 15% excise tax and exposing the plan fiduciary to personal liability for breach of fiduciary duty.

- **404(a)(5) Disclosure to Plan Participants** – **By August 30, 2012**, plan fiduciaries are required to make their initial disclosure of fees to all eligible employees (participating and nonparticipating), as well as to former employees and beneficiaries with account balances. Under 404(a)(5), plan fiduciaries are required to disclose the following:

    1. The information necessary to make informed decisions when selecting investments;
    2. An explanation of recordkeeping, administrative services and other expenses that are deducted from participant accounts;
    3. Fees for individual transactions, such as loan setup maintenance, and distributions, that are deducted from applicable participant's accounts.

    The first quarterly disclosure of fees actually charged to each participant's account was due on November 14, 2012.

For answers to questions about your fiduciary responsibilities under either the 408(b)(2) service-provider fee disclosure rules or 404(a) participant fee disclosure rules, go to nhhicks.com and click on Hicks Legal.

Can a Plan Invest in Real Estate?

A Plan can invest in real estate provided that the document would allow for it. Any discussion must include the various issues involved. While a plan may invest in real estate, once the issues are flushed out, it should be apparent that it is not generally an appropriate investment for the small plan.

These issues are: Prohibited Transactions, UBTI, Fiduciary Issues, Valuation Problems and Tax issues.

The trustees must avoid creating a prohibited transaction with any real estate investment. Prohibited transactions are transactions between the plan and a disqualified person that are prohibited by law. Prohibited transactions generally include the following transactions:

- A transfer of plan income or assets to, or use of them by or for the benefit of, a disqualified person;
- Any act of a fiduciary by which he or she deals with plan income or assets in his or her own interest;
- The receipt of consideration by a fiduciary for his or her own account from any party dealing with the plan in a transaction that involves plan income or assets;
- Any of the following acts between the plan and a disqualified person:
  Selling, exchanging, or leasing property,
  Lending money or extending credit, and/or
  Furnishing goods, services, or facilities.

The term "disqualified person" means a person who is:

- A Fiduciary;
- A person providing services to the Plan;
- An employer, any of whose employees are covered by the Plan;
- An Employee organization any of whose members are covered by the Plan;
- An owner, direct or indirect, of 50 percent or more of a participating employer;
- A family member of a disqualified person. Family member, for this purpose, means a spouse, ancestor, lineal descendant, or spouse of a lineal descendant.

Often, the trustee wants to buy or sell a piece of real estate to the trust. They may want a condo or a house for a family member to live in. They may want to buy an office building for their office. They may want a piece of property that they may retire too and want to buy it out later. All of these would be prohibited transactions.

What is Unrelated Business Taxable Income (UBTI?)

Whether income is UBTI depends on the type of tax-exempt organization that generates the income. The UBTI rules focus on the purpose for which an organization is tax exempt and whether certain activities are contrary to that purpose. The purpose of a qualified trust is to provide retirement income through investment of contributions made to the Trust. Therefore, the primary purpose of a qualified trust is to generate investment income.

The qualified trust is generally exempt from taxation in income that is derived from investment activity. The purpose of this rule is to protect taxable entities from unfair business competition from tax-exempt organizations. See Tres. Reg. Section 1.513-1(b). The following income derived by the qualified trust would be exempt income:

1. Common investment income (dividends, interest, etc.);
2. Royalties;
3. Rents. Rents from real property (land, building, etc), and rents from personal property leased with such property, are generally exempt. ***An exception is if the rent on the personal property (such as equipment) is not incidental to the total rent. If the rent is based on profits or if equipment rental is more than 10% of total rent, it would be taxed as UBTI;***
4. Gains on sell of property;
5. Debit-financed property;
6. S-Corporation investments;
7. Common Trust funds;
8. Securities lending.

If the trust conducts an active trade or business, the income derived from that activity is taxed as UBTI. The term “trade or business” means activity which is carried on for the production of income from the sale of goods or the performance of services.

It would be argued by the IRS that by personally fixing up buildings, marketing or acting as a landlord would fall under UBTI.

Clearly, a real estate agent who is leasing rentals or trading property would fall under these rules.

The purchase and sale of property normally does not subject the plan to UBTI tax on the gains derived from the sale. ***When the sales of property are regularly carried on however, the plan may be to be engaging in a trade or business.*** Issues such as the frequency or volume of the sales, and whether the properties are divided or improved prior to sale, are relevant in making the decision if such activity constitutes a trade or business. In PLR 9127045, the IRS, considering these factors ruled that the sale of parcels did not constitute a trade or business.

Taxation of UBTI

UBTI earned by the qualified trust is taxed under the tax rates for estates and trusts, as prescribed by IRS Code Section 1(e). To compute the tax under the rate schedule, substitute "UBTI" for "taxable income". The minimum tax is 35%. See IRC Code Section 1(i)(2).

- **<u>$1,000 exemption</u>.** A deduction of $1,000 is allowed in arriving at UBTI. See IRS Code Section 512(b)(12). If the UBTI for the trust's taxable year is $1,000 or less, no tax applies.
- **<u>Form 990-T</u>**. Form 990-T must be filed by the trustee to pay the tax on UBTI. The return is due by the 15th day of the 4th month following the close of the trust year.

Valuation is always an issue. The law requires that "Fair Market Value" be used for all reporting and valuation purposes. Given that real estate is very illiquid, a fair market value is open to scrutiny. An independent appraisal can give some relief, but how often. Every year, every three years, this can be expensive and time consuming just for reporting purposes. Clearly, just carrying it at the purchase price is not adequate.

In addition, supposed a one person plan wants to take the real estate out as an in-kind distribution. What value do you use? Taxes need to be paid on that value and it will be open to interpretation. I've seen many plans stuck with just real estate waiting for it to sell so it may be distributed because they didn't have the cash to pay the taxes.

This leads to Fiduciary Issues. If there are other participants in the plan, payouts and balances are based on this valuation. Under value and you pay out too little, over value and you hurt other participants. In addition, liquidity has been a huge problem in these plans. Real estate can take years to sell, what do you do with those who have a "piece" of that land and want to retire?

Another fiduciary issue is the red flag reporting for owning more than 10% in any asset class. It's a question on the 5500 and often real estate exceeds this amount. By answering this yes, you red flag your plan for a DOL audit.

Often, the person wanting to invest in real estate says, "I know real estate; I'm in the real estate business". Sound like UBTI and what about the diversification requirements imposed by the "prudent man investment rule".

Finally, the tax issues need to be discussed. Real estate owned outside a plan is able to deduct expenses, depreciate its costs and is treated as capital gains. In a plan, when the real estate is sold, any gain is treated as ordinary income when it's distributed.

Bottom Line: The best way to invest in real estate is to purchase raw land for 100% cash from a third party. Hold it for appreciation, and then sell it to a third party. You still have valuation and fiduciary issues, but can eliminate the others.

Determination of Controlled Group and/or Affiliated Service Groups

To determine whether the companies are affiliated or controlled please supply: the name of all business owners, percentage and relationship, each entity type, number of employees, nature of the business nature and any business relationship to one another. Show if any of the businesses provide services to one another or mutual third parties and the percentage of the services provided. List any existing qualified retirement plans the businesses may sponsor.

Controlled Group [IRC Codes 414(b)(c) and 1563]

A Controlled Group exists for businesses with a parent-subsidiary or brother-sister relationship.

Parent-Subsidiary Controlled Group: A parent-subsidiary controlled group exists when one business (common parent) owns at least 80% of one or more other businesses (subsidiaries).

Brother-Sister Controlled Group: A brother-sister controlled group exists when five or fewer persons own 80% or more of the stock value or voting power of each corporation and the same individuals together own more than 50% of the stock value or voting power of each corporation, taking into account the ownership of each person only to the extent such ownership is identical with respect to each organization (e.g. if a common owner owns 30% of one business and 80% of another business, the owner's identical ownership in the two businesses is 30%).

Affiliated Service Group [IRC Code 414(m)]

An Affiliated Service Group (ASG) is a group of employers treated as a single entity because of a combination of ownership and services rendered. An ASG can fall into one of three categories: (1) A-Organization Groups (A-Org) consists of an Organization designated as a First Service Organization (FSO) and at least one A-Org, (2) B-Organization Groups (B-Org) consists of an FSO and at least one B-Org, or (3) Management Groups.

An FSO must be a "service organization". An organization is a service organization if capital is not a material income producing factor. As a general rule, the capital is a material income producing factor if a substantial portion of the income of the business is attributable to the employment of capital in the business (e.g. inventories, plant, machinery, or other equipment.) In a service organization, fees would come from commissions or compensation for personal services, such as health, law, architecture, accounting, performing arts, and consulting.

The A-Organization Groups must consist of an FSO and another service organization, which is known as the A-Org. The A-Org must (1) have ownership interest in the FSO and (2) the A-Org must regularly perform services for the FSO or must be regularly associated with the FSO in performing services for third parties.

The B-Organization Groups must consist of an FSO and another organization, which is known as the B-Org (B-Org does not have to be a service organization). The B-Org must meet all of the following three requirements: (1) a significant portion of its business must be the performance of services for a FSO (or an A-Org with respect to the FSO), (2) the services must be historically performed by employees in the service field of the FSO or the A-Org's, and (3) 10% or more of the interest in the organization must be held, in aggregate, by highly-compensated employees.

The Management Groups must consist of a recipient organization and a management organization. To be an affiliated service group, the management organization's principal business must be the performance of management functions, on a regular and continuing basis for the recipient organization. There does not need to be any common ownership between the management organization and the organization for which it provides service.

Compliance Division Programs

The Internal Revenue Service and Department of Labor offer a comprehensive system of correction programs to sponsors of 401(a), 403(b) and Simplified Employee Pension (SEP) plans. Each program is designed to correct specific problems.

DOL Delinquent Filer Program (DFVC):

- Failure to file Form 5500.
- The DOL fees for small plans (fewer than 100 participants) are $10 per day after the due date, not to exceed $750 per return, with a maximum of $1,500 for multiple late returns. The DOL fees for large Plans (100 or more participants) are $10 per day after the due date, not to exceed $2,000 per return, with a maximum of $4,000 for multiple returns.
- NHI will charge annual administration fees plus $500 for DOL submission.

IRS Penalty Relief for Late 5500-EZ:

- Failure to file Form 5500-EZ owner-only plans.
- The IRS fee is $500 per delinquent return up to $1,500 per plan.
- NHI will charge $250 for each missed year to prepare 5500-EZ and submission.

IRS Voluntary Correction Program (VCP):

- Failure to timely adopt plan documents or restatement.
- The IRS fees are based on the size of the plan.
- NHI will charge document fees plus $500.

IRS Self Correction Program (SCP):

- Operational Failures such as document amendments, certain loan problems, ADP/ACP tests, top-heavy, 415 limits, and minimum distributions.
- There is no IRS fee.
- NHI will charge a fee of $500.

DOL Voluntary Fiduciary Correction Program (VFCP):

- Late deposit of 401(k) or employer contributions.
- There is no DOL fee.
- NHI will charge a fee of $1,500 (The client could incur additional NHI fees depending on the severity of the violation and the amount of time required.)

Determination of Controlled Groups or Affiliated Services Groups:

- If research needs to be completed to determine whether the companies are affiliated and/or controlled, our fee is $500 for a letter. If we cannot determine whether the companies are affiliated and/or controlled, NHI will charge $2,000 to file for an IRS determination letter.

Plan Audit Services:

- Our fees are $200 per hour.

NH HICKS

FEES FOR SERVICES

<u>401(k) Profit Sharing Plans:</u>
Installation/Documents (takeover no charge) ....$1250 + $10 per eligible participant
Administration...$1350 + $30 per eligible participant

<u>Defined Benefit Plans:</u>
Installation/Documents (takeover no charge) ....$1350 + $10 per eligible participant
Administration including actuarial certification.................................$2100 + $50 per eligible participant

<u>DB/DC Combination Plans:</u>
Installation/Documents (takeover no charge) ....$2700 + $20 per eligible participant
Administration including actuarial certification.................................$3550 + $50 per eligible participant

*Additional Fees will be added for the installation and administration of Cash Balance Plans

<u>Owner Only –401(k):</u>
Installation/Documents (takeover no charge) $550
Administration (assets less than $250,000)......................................$300
Administration (assets $250,000 and more)....................................$550

<u>Owner Only – Defined Benefit Plan:</u>
Installation/Documents (takeover no charge) $1300
Administration including actuarial certification.................................$1600

<u>Owner Only – DB/DC Combination Plans:</u>
Installation/Documents (takeover no charge) $1700
Administration including actuarial certification.................................$2000

<u>Special Transactions:</u>

Defined Contribution Plans
Comparability allocation (multiple runs) $250
Amendments, trust accounting or 5500 audit consulting ....$125 per hour
Distributions or extensions (annual loan $35) ....$ 95
QDRO or RMD...$225

Defined Benefit Plans
PBGC Reporting...$225
Trust accounting or 5500 audit consulting.......................................$125 per hour
Distributions or amendments $225
Loans (annual loan $35) or Extensions..$ 95

Our fees are offset by all third party payments we receive from investment companies.

8-1-2020